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August 22, 2008

Ms. Mary Rupp  
Secretary to the Board  
National Credit Union Administration  
1775 Duke Street  
Alexandria, Virginia 22314-3428

Dear Ms. Rupp:

Apple Federal Credit Union appreciates the opportunity to comment on NCUA's Notice of Proposed Rulemaking for 12 CFR Part 723 ("MBL rule") regarding potential changes to the Member Business Lending Regulations. The periodic review and revision of Section 723 allows Credit Unions to remain competitive in the market, and maintain safety and soundness. The current underwriting provisions in Part 723, has served the credit industry well in the recent economic downturn.

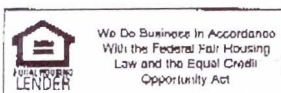
Our comments address issues that have arisen during the course of our credit union's and other credit unions' commercial loan underwriting and communications between credit unions and their NCUA examiners.

The discussion items are addressed below follow the format of the Advance Notice of Proposed Rulemaking and Comment.

#### 1. **Loan to Value Requirements ("LTV")**

The MBL rule requires all member business loans to be secured by collateral. 12 CFR 723.7(a). The maximum LTV ratio permitted for all liens is 80% unless the amount over 80% is covered by private mortgage insurance or is otherwise insured, guaranteed or subject to an advance commitment to purchase by government agencies. 12 CFR 723.7(a)(1). In any event, the loan to value ratio may not exceed 95%.

We believe that this provision of the regulation should remain the underwriting standard for the industry. The 80% LTV is competitive and appropriate. The existing LTV guidelines allow Lenders the flexibility needed to underwrite at a lower loan to value for some types of collateral if they choose to do so.



The downside of this rule is that many of the local and state economic development agencies extend subordinated debt in excess of the 80% LTV in total to provide more incentive to rehabilitate or upgrade properties to legitimate borrowers. In most cases this debt is only subordinated and does not fall into any of the above categories (i.e., guarantees or insurance), prohibiting the credit unions from participating in economic development proposals. For example if a borrower seeks a mortgage loan in the amount of 80% LTV and the local economic development agency is willing to make a subordinated loan that would increase the total indebtedness LTV to 85% to improve, for example, the facade of the building with the participation of a primary lender obtaining a first mortgage, as the regulation currently exists, it would prohibit the credit union from making such a loan without seeking a waiver of the LTV limit. The rule should exclude subordinated loans made from other lenders from the LTV calculation.

## 2. Exceptions to the Loan to Value Requirement

The exemptions to the loan to value requirement contained in Section 723.7 (d) with regard to unsecured MBL limits, MBL credit card lines, vehicles and definitions of fleet vehicles are competitive and appropriate. The existing provisions of the regulation do not need to be changed. If credit unions have the underwriting experience and wish to exceed the limits they have the ability to seek waivers provided in Section 723.10.

## 3. Construction and Development Loans

Construction and Development loans are the riskiest of all MBLs and do require greater regulatory restrictions. The current regulatory LTV is 75% with the suggestion to increase to 80%, making it the same as the general LTV requirement.

### (i) Calculation of Market Value

The 75% LTV is an appropriate and competitive standard. We do not believe that this should be changed. Rather, it is the interpretation of what comprises the market value and borrower equity that still needs clarification. Over the past few years the NCUA Office of General Counsel has issued legal opinions in this regard. However, there are still unanswered questions and NCUA examiners seem to be inconsistent on how "market value" is determined.

OGC Legal Opinion 01-0422, dated June 7, 2001 and OGC Legal Opinion 05-0243 dated May 25, 2005 define equity interest and market value.

As noted in the May 25, 2005 letter:

"The MBL rule requires a borrower to have a 25% equity interest in the market value of a construction or development project, unless the credit union obtains a waiver from the NCUA or the loan is otherwise exempt. 12 CFR. 723.3 (b). Therefore to determine the amount of required equity, a credit union must ascertain the market value of the project at the time the loan is made."

In the final MBL rule issued in 2003, the NCUA Board incorporated the June 7, 2001 legal opinion into the preamble noting that a project's market value at loan closing includes the appraised value of the land on which the project is to be built, less any liens

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plus the cost to build the project. The June 7, 2001, opinion letter also stated that closing costs cannot be included because those costs do not contribute to the market value of the project. ("We believe that a credit union cannot add closing fees such as points, mortgage fees and finance charges related to the financing of an MBL to the market value of a construction project. While these costs are incidental to the financing of a construction MBL and may be part of the acquisition cost for the borrower, they do not increase the project's value.")

As seen from the above, the NCUA's definition of market value relies upon the cost approach at the time of closing. This position is more conservative than the definition of market value used by other federal financial institution regulators. This approach results in a lower market valuation and thereby effectively lowers the amount that can be loaned when using the 75% Loan to Value, as a result of which credit unions are rendered uncompetitive. Additionally, the NCUA has not given the credit unions adequate guidance as to what other costs in a construction breakdown estimate are properly included in the market value calculation. We have received information from NCUA personnel that only "hard" costs can be included in the definition. We have also been told by some NCUA examiners that other "soft" costs like feasibility studies, appraisals and environmental audits do not add to the underlying value of the project and cannot be calculated into market value.

We have seen that an appraiser typically evaluates a given cost breakdown against an industry standard such as Marshall & Swift to determine if the costs are accurate and appropriate. We suggest that NCUA rely upon the guidance provided in USPAP AQ-22, as well as other USPAP pronouncements to ascertain what costs are properly included in the market value determination.

In summary, the approach to determine market value in construction and development loan needs clarification and, if possible, we recommend that the NCUA use standards similar to those relied upon by the other federal financial institution regulators. A definition of market value is necessary to avoid inconsistent interpretations.

## (ii) Calculation of LTV

In the preamble to the final MBL rule issued in 2003 (68 Fed. Reg. 56537, 56540) NCUA states that: "....it is more prudent to use the market value of the project at the time the loan is made to determine the value of the financed project. This includes the appraised value of the land owned by the borrower on which the project is to be built, less any liens, plus the cost to build the project." The "less any liens" clause of the phrase is being interpreted literally as a formula and has caused a great deal of confusion. We suggest that the market value at the time of closing should be the "as is" appraised value of the land (and/or existing structure) plus the value of improvements (costs). Encumbrances (i.e., liens) should not affect market value since "market value" is independent of any liens that encumber the property. Rather, it is the "collateral value" that takes into account the liens. Any existing encumbrance will only impact the limited 75% loan to

The ability to seek a waiver from the limitations of Section 723 provides opportunities for credit unions to remain competitive and at the same time maintain safety and soundness. The primary concern in seeking a waiver on an individual loan is the six week time frame for approval. When we inform borrowers of the extra step in underwriting, most business

#### 7. Waivers:

Perhaps adding examples would be beneficial for some credit unions. The participation regulation can be cross referenced with Part 723 to enhance clarity.

#### 6. Participations:

Providing specific examples in the regulatory text would help to clarify the concerns relating to independence.

#### 5. CUSO's and Experience Requirement:

The MBL rule requires a credit union making MBLs to use the services of an individual with at least two years direct experience with the type of lending in which the credit union will engage. Depending upon the complexity of the business loan, two years of experience may not be sufficient experience. For example, if a credit union is making a simple loan to a sole proprietorship that is similar to a consumer loan, two years experience would be adequate. If the loans are more complex such as non owner occupied investment real estate with lease valuations etc, then the two year experience requirement may be inadequate. The loan officer would not have had sufficient time to experience downturns in the market or suffered through the school of hard knocks. It should be incumbent upon the credit union to seek the proper knowledge and experience through outsourcing if such experience is not present in the credit union. Five to seven years experience for loan officers would be a more realistic time frame for more complex loans and unique industries.

#### 4. Experience Requirement:

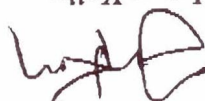
Value of existing land/improvements: \$1,000,000.00  
Value of improvements to be made: \$800,000.00  
Existing lien: \$750,000.  
Formula used by other commercial institutions (the competition):  
 $\$1,000,000. + \$800,000. = \$1,800,000. \text{ Market Value}$   
Loan Amount:  $\$1,800,000 \times .75\% = \$1,350,000.$   
Borrower Cash Equity needed at closing \$450,000.  
Loan Payoff: \$750,000.  
New Money: \$600,000.  
Equity Needed: \$450,000.  
Total Project \$1,800,000.

value calculation and the amount of equity required as illustrated by the following example:

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Larry Kelly  
CEO & President



Sincerely,

Thank you for the opportunity to comment on Part 723 Member Business Loans.

procedures.

We do not advocate greater restrictions concerning underwriting factors required by 723.6(g). This is best left to be determined by the individual credit unions policies and

#### 8. Degree of Regulatory Limits:

owners perceive this as an additional hurdle in conducting business with the credit union. Credit unions can lose the loan to an institution with more underwriting flexibility. If the waivers can be streamlined and responses made in a timely fashion it is believed more credit unions would utilize waiver opportunities.